

FTC Workshop: Protecting Consumer Interests in Class Actions
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Panel #1: The Use of "Coupon" Compensation and Other Non-Pecuniary Redress

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I. Coupons as Compensation: A Just Settlement for Class Members or Just a Sell-Out?

As a theoretical matter, class actions can serve a valuable function by resolving claims of millions of class members whose injuries would otherwise go unredressed or would otherwise involve separate expensive and drawn out lawsuits by numerous law firms. *See* 2 ALBA CONTE & HERBERT B. NEWBERG, *NEWBERG ON CLASS ACTIONS* § 5:2 (4th ed. 2003). Defendants also may prefer a class action to resolve numerous claims rather than litigate them piecemeal. However, it is not unusual for 15 or more different plaintiffs' law firms to get a nominal client and file copy-cat class action lawsuits which are later consolidated. The firms then ride each others gravy train as they seek attorneys' fees for work that is often duplicative or unnecessary, thereby undermining one of the very purposes of allowing class actions, *i.e.*, the reduction of litigation and transaction costs.

Because the targets of class action cases are generally large businesses, it is no secret that what drives these cases is the prospect of forcing settlements and being awarded huge attorneys' fees even where the "injury" is *de minimus* or liability doubtful. The actual risk assumed of not recovering attorneys' fees in a class action case filed on a contingency basis is not the risk of losing at trial as plaintiffs' attorneys like to claim in their motions for huge fee awards, but the risk of not settling the case. If a case is likely to settle, attorneys' fees are essentially assured. Furthermore, the chances of settling the case increase dramatically following class certification, a feat that is easily accomplished under current legal standards. *See* Robert G. Bone & David S. Evans, *Class Certification and the Substantive Merits*, 51 DUKE L.J. 1251 (2002); Thomas E. Willging, *et al.*, *An Empirical Analysis of Rule 23 to Address the Rulemaking Changes*, 71 N.Y.U.L. REV. 143 (1996) (after class is certified, class actions are up to five times more likely to settle).

In the course of settling class action cases, plaintiff's counsel do not feel beholden to absent class members and are more inclined to collude with the defendants to maximize their fees and limit class recovery. *See* DEBORAH R. HENSLER ET AL., *CLASS ACTION DILEMMAS, PURSING PUBLIC GOALS FOR PRIVATE GAIN* 20 (2000). More troubling, many settlements provide for non-monetary compensation in the form of coupons of dubious value for certain products or services. As the *Washington Post* (Nov. 25, 2002) editorialized, when cases settle, the class members often "get token payments, while the lawyers get enormous fees.

This is not justice. It is an extortion racket that only Congress can fix."

While Congress as well as some states are indeed trying to fix the "extortion racket" as discussed further below, both state and federal trial and appellate courts can and must do their duty as fiduciaries to the entire class to ensure that the settlements agreed upon by the parties are "fair, reasonable, and adequate" as required by Rule 23. Their job is made more difficult when the settlement provides for non-monetary relief such as coupons, injunctive relief, or *cy pres* distributions.

II. Evaluating Coupons and Non-Cash Compensation.

A. What is the case worth?

Before courts can intelligently approve any settlement, whether for cash, coupons, vouchers, credits, products or injunctive or other relief, as "fair, reasonable, or adequate," the courts must, at a minimum, first know 1) the approximate size of the class, and 2) the approximate value of the underlying case. In determining both the procedural and substantive fairness of the settlement, courts often look at the merits at the case, the procedural fairness of the settlement negotiations, the objections filed by class members, and other factors. Courts may also enlist or rely on experts to help them make these assessments.

Technically speaking, there really are no class action settlements where cold cash is awarded. Rather, monetary awards are made by a negotiable instrument in the form of a check, which is itself a kind of coupon. These "coupons" can be redeemed for cash and are surely the best kind of coupons, but like real coupons, settlement checks often have an expiration date within which the check can be negotiated, such as six months. The check may be for such a small amount, such as 35 cents or less (see *Simon v. Schwartz* - Citibank case regarding credit card overcharges), that the transaction costs for redeeming the check/coupon may not be worth it, although the aggregate amount awarded to the entire class is large. Or the check itself, because of its small physical size or peculiar appearance, may be regarded as a "phony" or mock check of the kind that are often found in junk mail, and may not be negotiated by the class member. Where the transaction costs for processing a check are large in relation to the amount of the check, as in the Citibank case, the consumer would be better off receiving a larger amount that is simply credited to his or her account.

Assuming the court has made a fair determination of what the case is worth for settlement purposes, it must then evaluate the coupons and other non-pecuniary relief to determine whether the value of the settlement adequately matches the value of the case.

B. Coupon Characteristics and Considerations

The actual value of coupons depend upon several characteristics other than their face value. In some cases, coupons may be more desirable to class members, depending upon their features. For example, if the class member can obtain a retail product he or she regularly uses

rather than the reduced cash equivalent reflecting the wholesale price or manufacturers' cost of the product, consumers receive more value, even though the cost to the defendant is the same in either scenario (or the cost may be even less if the coupon induces additional purchases). Thus, it may be worth more to the consumer to receive a \$25 coupon or voucher redeemable for a product or service regularly purchased at approximately the same price, rather than receive \$10 in cash (assuming that \$10 is the true cost equivalent of the \$25 coupon to the defendant). On the other hand, the consumer may prefer a smaller cash amount over a higher retail value coupon if the coupon is unlikely to be redeemed, such as a \$50 coupon towards the purchase of a cruise vacation.

In one unusual case that is pending, the proposed settlement provides for in-kind compensation rather than coupons or cash. In *Azizian v. Federated Dep't Stores*, No. 3:03 CV-03359 SBA (N.D. Cal.), the proposed settlement provides class members (up to 38 million consumers who purchased high-end cosmetics) with the opportunity, but not the guarantee, to claim a special cosmetic gift valued by the defendants at \$18-\$25 (with an aggregate retail value of \$175 million) while supplies last, if they show up at certain department stores during a very limited week-long giveaway period. The plaintiffs' attorneys, who admit that their case is so weak that their consultant estimated that the case has only a 7% chance of winning, would receive a fat fee award of up to \$24 million payable by the defendants as agreed to, if approved by the court.

In a case like this, many consumers would prefer to receive a coupon worth \$18-\$25 as a credit for cosmetics they actually use, or even obtain a much smaller cash equivalent, rather than incur the not insubstantial transaction costs of driving to the store during the specified week giveaway period, waiting in line, and filling out a claim form for a small gift item that may not even be available. See Objections filed by Tracy Lynn Anderson, *et al.* in *Azizian* (copy provided to FTC for posting with these remarks and also available on Washington Legal Foundation's website at www.wlf.org).

Even if a case is very weak in terms of liability, and the low settlement offer (whether in cash or coupons) reflects that weakness, the court may nevertheless reject the settlement on the grounds that if the plaintiffs were to lose at trial, the class members were not deprived of anything substantial. For example, during the recent settlement hearing in a securities class action case against Halliburton, Texas federal Judge Barbara Lynn berated the parties for trying to settle a huge multimillion dollar case for \$6 million with half earmarked for attorneys' fees: "All of a sudden the great case [as touted by the plaintiffs' attorneys] becomes positively rank." *Dallas/Fort Worth Star-Telegram* (Aug. 26, 2004). When the plaintiffs' attorney conceded that his case was very weak, and that "it was better to get something rather than nothing," the judge responded by noting that since the amount to be awarded to each class member would be negligible, the class wouldn't lose much if she denied the settlement, and the case were lost at trial.

Although Halliburton's attorney told the court that rejecting the settlement would "encourage frivolous lawsuits," it would seem that the opposite is true: as long as plaintiffs' attorneys can get millions of dollars for bringing frivolous cases with the agreement of their

corporate targets, frivolous lawsuits will abound. Alternatively, the court could also deny or sharply reduce the fee award to discourage such frivolous lawsuits as objectors argued in the *Azizian* case. Ideally, a "losers pay" procedure would deter the filing of such cases.

Some of the characteristics of coupons to be considered in their evaluation include the following:

1. What is the claim rate? Most class actions require class members to fill out a claim form by a certain cut-off date to obtain compensation. If notice to the class is inadequate, the time to respond once notified is short, or the requirements for filing a claim are cumbersome or require receipts, the claim rate may be low. In one case, the claim rate was less than one percent. *In re Cuisinart Food Processor Antitrust Litigation*, 1983-2 CCH Trade Cases 65,680 (D. Conn. 1983). Also, many class action settlements involving a common fund have a *pro rata* payout rather than a *per capita* award; therefore, the smaller number of claimants, the more each claimant will receive from the common fund. Is this true for non-pecuniary settlements as well?

2. What is the redemption rate? Assuming class members actually receive a coupon or voucher, what is the redemption rate? The average redemption rate on food and beverage coupons are between 2% and 6%. Accordingly, the court should value the settlement by sharply discounting the face value of the coupons to determine both the fairness of the settlement and the appropriate amount of attorneys' fees. Coupons with small face amounts that require the class member to purchase a big ticket item, such as a vacation cruise or a car, may be of no value to the class member. On the other hand, coupons for small amounts to be redeemed for small consumer products that are purchased frequently may be more valuable to the consumer than cash. The use of a *cy pres* distribution for unclaimed coupons should be critically examined to ensure that the *cy pres* is not being used to cover-up a defective coupon plan.

3. What are the time restrictions? Obviously, coupons that must be redeemed in a short amount of time are less valuable than those which have a longer redemption period.

4. What are the Transferability/Convertibility features? Coupons which allow the class member to transfer them to others or to convert them into cash, even at a discount or through coupon brokers, such as the Chicago Clearing Corporation, are more valuable than those without such features.

5. What are the views of the class members? The court should carefully consider the views of objecting class members as to the perceived value of the coupon or other non-pecuniary settlement. The fact that there are few objectors relative to the size of the class should *not* be taken as any indication of the views of the class members as a whole because most class members have not actually "received" notice of the proposed settlement, despite claims by so-called class action claims consultants and experts in some cases that 90 percent of the class were "exposed" to the notice buried in the back pages of newspapers and magazines.

Being "exposed" to a class action notice in this way is like being exposed to carbon monoxide - you don't know about it until it's too late. The time to file objections or to opt-out of a class action should be a minimum of 60-90 days from the receipt of the notice rather than the few short weeks which is often the case; and the time to file a claim should be as long as possible. Courts may determine that additional or supplemental notice is necessary.

Before approving a settlement, courts may require the parties to conduct a relatively inexpensive poll of a sample of class members to determine a) what percentage of the class actually "received" or saw the notice, and b) whether they prefer coupons or cash.

III. Measures That May Help Ensure That Settlements Involving Coupons or Non-cash Payments Are Valuable to Class Members.

A. Reduce Attorney Fees and Make Them Payable in Coupons or Noncash

Awards. While courts must either approve or disapprove a proposed settlement that contains coupons or other noncash payments, courts have broad discretion in awarding fees, and have on rare occasions awarded all or part of fees in noncash payments to express their displeasure with noncash settlements. Furthermore, courts should *not* base the fee as a percentage of the estimated coupon value of a case; rather, the fee should be based on a lodestar approach. See *Dunk v. Ford Motor Company*, 48 Cal. App. 4th 1794 (1996) (percentage method should only be used when the common fund is certain or an easily calculable sum of money). Courts can also refuse to award attorneys' fees altogether. For filing frivolous lawsuits, courts should be able to require plaintiffs' attorneys to pay the defendants' attorneys' fees.

Cases:

In re Brown Company Securities Litigation, 355 F.Supp. 574, 593 (S.D.N.Y. 1973). Since the settlement in this securities class action case called for recovery in both cash and stock warrants, court held that because counsel "expressed faith and confidence in the value of the settlement for their clients, it is not unreasonable to require them, to some extent, to stand equally with plaintiffs in sharing the distribution in kind." Instead of awarding \$400,000 in cash for attorney's fees, the court awarded \$292,000 in cash and \$108,000 in warrants.

Aburime v. Northwest Airlines, Inc., No. 3-89-402 (D. Minn. Aug. 16, 1991) Counsel was paid in cash and \$200,000 in non-transferable credit or air travel.

Glassman v. Renaissance Cruises, Inc., Fla. Cir. Ct. (17th Jud. Dist., Broward County), 8 Fla. Weekly Supp. 379 (2001). Settlement of piggy-back class action for unlawful "port charges" for cruises included vouchers, fully transferable, but worth only \$10 to \$60 towards fares for future cruises. Contested fee request of \$1.3 million reduced to a court-reduced lodestar of \$293,000, of which 25% was to be paid in vouchers.

In re: Magazine Antitrust Litigation, 2004 U.S. Dist. LEXIS 1845 (S.D.N.Y. 2004). Class action suit against magazine publishers for antitrust violations in pricing policies resulted in settlement affording minor injunctive relief only (no coupons or free magazines) that was technical in nature and did not confer a "substantial benefit" on the class to meet the "common benefit" standards for the award of fees. Consequently, the court denied the entire request for attorneys' fees.

Comment: These and other cases properly limit attorneys' fees for obtaining only non-pecuniary relief to the class, but because they are rare after-the-fact rulings, they may serve more to punish the attorneys for a relatively poor performance as class counsel than engender better settlements for the class (unless fees not awarded are given to the class instead). Accordingly, forward-looking statutory or court rules may do a better job of deterring or limiting questionable coupon settlements in the future.

Statutory:

Texas. For class action cases filed on or after September 1, 2003 in Texas, Tex. Civ. Prac. & Rem. Code § 26.003 (2004) provides that "in a class action, if any portion of the benefits recovered for the class are in the form of coupons or other noncash common benefits, the attorney's fees awarded in the action must be in cash and noncash amounts in the same proportion as the recovery for the class." Texas R. Civ. Proc. 42(i), (j) (same).

Federal. Section 1712 of the Class Action Fairness Act of 2004, S. 2062, pending before the U.S. Senate deals with coupon settlements.

Section 1712(a) provides that the portion of the fees "attributable to the award of the coupons shall be based upon the value to class members of the coupons *that are redeemed*." Query: Would this provision apply to settlements involving giveaways of consumer products or services where no formal "coupon" is offered, *e.g.*, *Azizian v. Federated Dep't Stores* (cosmetics giveaway); *Court Reporting Services v. Compaq Computer* (free downloadable software)?

Section 1712(b) provides that if fees are not based on the value of the coupons, the lodestar approach may be used.

Section 1712(c) provides that if there is a mixed settlement that provides for both coupons and equitable or injunctive relief, a portion of the fees shall be based on the coupons redeemed, and a portion based on the equitable relief using the lodestar approach.

Section 1712(d) provides that a court "may in its discretion upon motion of a

party" use an expert to determine value of coupons redeemed. Can a class member can make the motion? Court already has authority under Rule 53 to appoint a Special Master to make that determination.

Section 1712(e) provides that coupon settlements may be approved only after written finding that the settlement is "fair, reasonable, and adequate" for class members. The court has discretion to order that "unclaimed coupons" (as opposed to unredeemed coupons) may be given to charity or governmental organizations, *i.e.*, *cy pres* distribution, but that amount cannot be used to calculate attorneys' fees.

B. Monitoring the Settlement.

1. Delay Awarding Attorneys' Fees Until After Class is Compensated

In many class action cases, attorneys' fees are awarded *before* class members receive compensation, whether the compensation is in the form of cash, coupons, products, or a combination thereof. Plaintiffs' attorneys have no incentive to ensure that coupon or product giveaway awards are successful if they are paid up front. Consequently, courts should delay making the determination of both the amount of fees and payment of fees, or at least a portion thereof, until *after* the coupons have been claimed and redeemed. If the claim and redemption rates are very low, that fact should be used by the court in determining the amount of fees that should be awarded to class counsel. Courts should also require a final accounting of a class action in all cases to determine whether the settlement was properly executed, and may appoint a monitor to assist the court.

2. Require Centralized Posting of All Class Actions on Internet.

Many major class action cases have their own websites where class members can obtain valuable information about the case and learn how to file a claim, object, or opt-out. However, if class members do not know about the existence of the website, the utility of the site is marginal. Parties should be required by court rule or by legislation to post each major class actions filed in federal and state courts on its own dedicated website. In turn, links to those websites with a summary of the case should be posted on a centralized website, ideally one administered by the Federal Trade Commission. In that way, consumers can regularly "surf" the FTC website to see if they are members of a class action, access that class action's website via a hyperlink, and exercise their rights accordingly. In addition, such a website would provide invaluable information to counsel, the parties, the courts, objectors, and interested academics.

III. Conclusion

Courts should carefully scrutinize proposed settlements, paying particular attention to settlements that provide for coupons and similar relief to ensure that the settlement is fair, reasonable, and adequate. Courts should also ensure that the attorneys' fees in coupon cases are not excessive, reflect the value received by the class, and not be greater than the lodestar amount.

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